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IFAD

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# Report on IFAD's investment portfolio for the first quarter of 2010

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For: **Information**

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# Report on IFAD's investment portfolio for the first quarter of 2010

## I. Executive summary

1. During the first quarter of 2010, IFAD's prudent investment policy and high-quality instruments contributed to protecting the investment portfolio from the turmoil in the global financial markets.
2. The value of the investment portfolio in United States dollar terms decreased by US$93,038,000 equivalent, from US$2,598,687,000 equivalent at 31 December 2009 to US$2,505,649,000 equivalent at 31 March 2010. The main factors for this decrease were net disbursement outflows and foreign exchange movements, which were partially offset by the net investment income.
3. The investment portfolio's rate of return for the period is 1.07 per cent, which translates into an investment income amount of US$25,778,000 equivalent, inclusive of all fees and securities lending cash collateral activities.

## II. Introduction

4. This report on IFAD's investment portfolio presents final data on the first quarter of 2010. It consists of the following sections: market conditions; asset allocation; investment income; rate of return; composition of the investment portfolio by currency; securities lending cash collateral; liquidity level in IFAD's investment portfolio; and risk measurement.

## III. Market conditions

5. Fixed-income markets began the year on a favourable note, with all IFAD's asset classes generating positive returns, especially during the months of January and February. IFAD's global government bonds asset class generally benefited from investors' demand for safer higher-quality issuers who manage their debt better than others. The recovering economic outlook also favoured this trend. The diversified fixed-interest asset class performed positively, partly as a result of the continued recovery from depressed valuations and partly as a result of investors' seeking higher-yielding quality assets. The inflation-indexed bonds asset class also benefited from demand for safe high-quality government debt.
6. During the period, some European peripheral sovereign countries experienced significant market pressure caused by excessive debt burden coupled with a negative economic outlook. IFAD's conservative investment policy protected the portfolio from exposure to the debt issued by these countries.
7. In the currency market, the United States dollar appreciated against the euro (+6.03 per cent), the pound sterling (+6.46 per cent) and the Japanese yen (+0.37 per cent).

## IV. Asset allocation

8. Table 1 shows the movements affecting the investment portfolio's major asset classes during the first quarter of 2010 and compares the portfolio's asset allocation at the end of the quarter with the investment policy allocation.
9. During the period, there was a cash outflow of US$55,724,000 equivalent from the internally managed operational cash portfolio, representing disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member States' contributions.

10. The appreciation of the United States dollar against the euro, pound sterling and Japanese yen, resulted in a decrease in the portfolio balance in United States dollar terms by US$62,508,000 equivalent during the first quarter of 2010.

11. The above movements, combined with an investment income of US$25,194,000[1] equivalent, decreased the overall investment portfolio value by US$93,038,000 equivalent for the period.

Table 1
**Movements affecting the asset allocation within the portfolio, first quarter 2010**
(Thousands of United States dollars equivalent)

| | *Operational cash*[a] | *Held-to-maturity* | *Government bonds* | *Diversified fixed-interest bonds* | *Inflation-indexed bonds* | *Total* |
|---|---|---|---|---|---|---|
| **Opening balance (1 January 2010)** | **184 243** | **402 809** | **1 110 757** | **466 993** | **433 885** | **2 598 687** |
| Investment income[b] | 234 | 3 833 | 9 405 | 7 845 | 3 877 | 25 194 |
| Transfers due to allocation | 63 644 | 6 908 | (35 552) | (35 000) | - | - |
| Transfers due to expenses/income | (1 248) | 42 | 563 | 361 | 282 | - |
| Net disbursement[c] | (55 724) | - | - | - | - | (55 724) |
| Movements on exchange | (4 572) | (12 407) | (36 966) | (12) | (8 551) | (62 508) |
| **Closing balance by portfolio (31 March 2010)** | **186 577** | **401 185** | **1 048 207** | **440 187** | **429 493** | **2 505 649** |
| Actual asset allocation (percentage) | 7.5 | 16.0 | 41.8 | 17.6 | 17.1 | 100.0 |
| Investment policy asset allocation[d] (percentage) | 5.5 | 16.0 | 43.4 | 15.1 | 20.0 | 100.0 |
| **Difference in asset allocation (percentage)**[e] | **2.0** | **-** | **(1.6)** | **2.5** | **(2.9)** | **-** |

[a] Cash and time deposits held with banks, readily available for disbursing loans, grants and administrative expenses.
[b] Investment income is further detailed in table 2.
[c] Disbursements for loans, grants and administrative expenses net of cash receipts and encashment of Member State contributions.
[d] The investment policy allocation for the held-to-maturity portfolio is set to match the current 16.0 per cent asset allocation in the investment portfolio.
[e] The differences between policy and actual asset allocations are impacted by fluctuations in market prices and currencies. The asset allocation is reviewed and realigned from time to time.

12. In December 2009, US$10,257,000 equivalent was temporarily transferred from the held-to-maturity to the operational cash portfolio pending strategic reinvestment. As a consequence in January 2010, this amount was transferred back in to the held-to-maturity portfolio for reinvestment. Meanwhile, approximately US$3,349,000 of coupon income generated from the held-to-maturity portfolio was progressively transferred to the operational cash portfolio during the first quarter of 2010.

13. In March 2010, a total US$70,552,000 equivalent was transferred from the government bonds portfolio (US$35,552,000 equivalent) and diversified fixed-interest portfolio (US$35,000,000 equivalent) to cover disbursement needs in the operational cash portfolio.

# V. Investment income

14. In the first quarter of 2010, the aggregate investment income amounted to US$25,778,000 equivalent, inclusive of all realized and unrealized gains and losses. Table 2 presents a summary of the first quarter 2010 investment income broken down by asset class.

[1] This figure does not include the impact of the unrealized gain/loss of the securities lending cash collateral reinvestment shown in table 2. The reason is that the security lending cash collateral is not directly related to any asset classes within the investment portfolio and therefore its market value change shall not affect the portfolio's asset allocation.

Table 2
**Breakdown of investment income by asset class and the impact of the reinvested securities lending cash collateral, first quarter 2010**
(Thousands of United States dollars equivalent)

| | *Operational cash* | *Held-to-maturity* | *Government bonds* | *Diversified fixed-interest bonds* | *Inflation-indexed bonds* | *Subtotal* | *Securities lending cash collateral impact* | *Total* |
|---|---|---|---|---|---|---|---|---|
| Interest from fixed-interest investments and bank accounts | 105 | 4 106 | 7 464 | 3 595 | 1 885 | 17 155 | - | 17 155 |
| Realized capital gains | 164 | - | 1 799 | 1 453 | 1 784 | 5 200 | - | 5 200 |
| Unrealized capital gains | - | - | 705 | 3 091 | 490 | 4 286 | 584 | 4 870 |
| Amortization/accretion[a] | - | (231) | - | - | - | (231) | - | (231) |
| Income from securities lending | - | 11 | 30 | 12 | 12 | 65 | - | 65 |
| **Investment income before fees and taxes** | **269** | **3 886** | **9 998** | **8 151** | **4 171** | **26 475** | **584** | **27 059** |
| Investment manager fees | - | - | (421) | (240) | (222) | (883) | - | (883) |
| Custody fees/bank charges | (41) | (12) | (65) | (21) | (28) | (167) | - | (167) |
| Financial advisory and other investment management fees | - | (41) | (107) | (45) | (44) | (237) | - | (237) |
| Taxes recoverable | 6 | - | - | - | - | 6 | - | 6 |
| **Investment income after fees and taxes** | **234** | **3 833** | **9 405** | **7 845** | **3 877** | **25 194** | **584** | **25 778** |

[a] A period's amortization amount represents a portion of the difference between the purchase price and the final redemption value of the held-to-maturity investments as per the International Financial Reporting Standards.

# VI. Rate of return

15. The rate of return of IFAD's investment portfolio is calculated in local currency terms without reflecting the impact of foreign exchange movements which is neutralized through the currency alignment.

16. The investment portfolio returned a positive 1.07 per cent in the first quarter of 2010, inclusive of all fees and securities lending cash collateral activities.

Table 3
**Quarterly rates of return on IFAD's investments for 2009 and first quarter 2010**
(Percentages in local currency terms)

| | *Quarterly rates of return in local currency* | | | | |
|---|---|---|---|---|---|
| | *1st quarter 2009* | *2nd quarter 2009* | *3rd quarter 2009* | *4th quarter 2009* | *1st quarter 2010* |
| Operational cash | n.a. | n.a. | n.a. | n.a. | n.a. |
| Held-to-maturity | 0.99 | 1.12 | 1.11 | 1.07 | 0.97 |
| Government bonds | 1.14 | (0.28) | 0.96 | 0.34 | 0.99 |
| Diversified fixed-interest bonds | 0.54 | 0.81 | 3.54 | 0.28 | 1.75 |
| Inflation-indexed bonds | 2.26 | 1.06 | 2.57 | 1.63 | 1.05 |
| **Net rate of return[a]** | **1.38** | **0.61** | **1.73** | **0.66** | **1.07** |

[a] Inclusive of all securities lending cash collateral activities
Note: n.a.: not applicable

17. The differences between the rates of return among the mandates are due to the different characteristics of asset classes and demonstrate the positive impact of portfolio diversification.

# VII. Composition of the investment portfolio by currency

18. The majority of IFAD's commitments are expressed in special drawing rights (SDRs). Consequently, the Fund's overall assets are maintained in such a way as to ensure that commitments for undisbursed loans and grants denominated in SDRs are matched, to the extent possible, by assets denominated in the currencies and ratios of the SDR valuation basket. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in the same currency.

19. The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be part of the basket and what their percentage weight should be at the date of reweighting of the basket.

20. The units for each of the four currencies making up the SDR valuation basket were determined on 30 December 2005 in such a way that the value of the SDR was precisely US$1.42927, in terms of both the old units and the new units, which became effective on 1 January 2006. The applicable units, together with their weights as at 1 January 2006 and 31 March 2010, are shown in table 4.

Table 4
**Units and weights applicable to SDR valuation basket**

| | *1 January 2006* | | *31 March 2010* | |
|---|---|---|---|---|
| *Currency* | *Units* | *Percentage weight* | *Units* | *Percentage weight* |
| United States dollar | 0.6320 | 43.7 | 0.6320 | 41.6 |
| Euro | 0.4100 | 34.3 | 0.4100 | 36.5 |
| Yen | 18.4000 | 10.9 | 18.4000 | 12.9 |
| Pound sterling | 0.0903 | 11.1 | 0.0903 | 9.0 |
| **Total** | | **100.0** | | **100.0** |

21. At 31 March 2010, assets in the form of cash, investments, promissory notes and contribution receivables from Member States under the Fifth, Sixth, Seventh and Eighth Replenishments, net of provisions, amounted to US$3,105,054,000 equivalent, as summarized in table 5 (compared with US$3,209,460,000 equivalent at 31 December 2009).

Table 5
**Currency composition of assets in the form of cash, investments and other receivables[a]**
(Thousands of United States dollars equivalent)

| *Currency* | *Cash and investments* | *Promissory notes* | *Contribution receivables from Member States* | *Total* |
|---|---|---|---|---|
| United States dollar group[b] | 1 131 474 | 186 968 | 96 584 | 1 415 026 |
| Euro group[c] | 782 164 | 121 273 | 104 525 | 1 007 962 |
| Yen | 348 720 | 43 842 | 34 114 | 426 676 |
| Pound sterling | 242 773 | - | 12 617 | 255 390 |
| **Total** | **2 505 131** | **352 083** | **247 840** | **3 105 054** |

[a] Includes only assets in freely convertible currencies, and excludes assets in non-convertible currencies of US$512,000 equivalent for cash and investments, and US$1,399,000 equivalent for promissory notes.
[b] Includes assets in Australian, Canadian and New Zealand dollars.
[c] Includes assets in Swiss francs, Swedish kronor, and Danish and Norwegian kroner.

22. The alignment of assets by currency group against the SDR valuation basket as at 31 March 2010 is shown in table 6. The balance of commitments denominated in United States dollars at 31 March 2010 amounted to US$151,825,000 equivalent, composed of the General Reserve (US$95,000,000) and commitments for grants denominated in United States dollars (US$56,825,000).

Table 6
**Alignment of assets per currency group with the SDR valuation composition as at 31 March 2010**
(Thousands of United States dollars equivalent)

| *Currency* | *Asset amount* | *Less: commitments denominated in US dollars* | *Net asset amount* | *Net asset amount (percentage)* | *SDR weights (percentage)* | *Difference (percentage)* |
|---|---|---|---|---|---|---|
| US dollar group | 1 415 026 | (151 825) | 1 263 201 | 42.8 | 41.6 | 1.2 |
| Euro group | 1 007 962 | - | 1 007 962 | 34.0 | 36.4 | (2.4) |
| Yen | 426 676 | - | 426 676 | 14.5 | 13.0 | 1.5 |
| Pound sterling | 255 390 | - | 255 390 | 8.7 | 9.0 | (0.3) |
| **Total** | **3 105 054** | **(151 825)** | **2 953 229** | **100.0** | **100.0** | 0.0 |

23. As at 31 March 2010, there was a shortfall in the euro currency group of 2.4 per cent and in the pound sterling of 0.3 per cent. This was offset by an excess allocation in Japanese yen of 1.5 per cent and in the United States dollar currency group of 1.2 per cent.

# VIII. Securities lending cash collateral

24. In March 2009, it was decided to downsize IFAD's securities lending operations to US$350 million equivalent, based on acceptable risk/return profiles. This target was successfully reached in August 2009. As market liquidity continued to improve and unrealized losses progressively decreased, IFAD decided to liquidate a group of securities identified as most at risk. In line with IFAD’s prudent investment management, the liquidation was implemented in an orderly manner in December 2009. While realizing some losses of US$2,391,000 equivalent in 2009, an overall gain for the period amounted to US$16,186,000 equivalent. The Treasury Division will continue to monitor the securities lending cash collateral activities and its future operations are currently reviewed together with IFAD’s overall investment and liquidity policies. The status of the steps taken in 2009 was also reported to the Audit Committee at its 113th meeting, in April this year. As part of the status

update, IFAD reported on its collaboration with its global custodian to enhance the accounting and reporting of the securities lending in 2010.

25. The market value of cash collateral reinvested against securities lent as at 31 March 2010 was US$197,743,000 equivalent, with a corresponding liability to the borrowers for US$198,387,000 equivalent. The asset class as well as credit quality compositions of the cash collateral reinvested against securities lent are shown in table 7.

Table 7
**Composition and credit ratings[a] of the cash collateral reinvested against securities lent as at 31 March 2010**
(Thousands of United States dollars equivalent)

| | *AAA* | *AA* | *A* | *BBB* | *Total* | *Percentage* |
|---|---|---|---|---|---|---|
| Cash | 96 868 | - | - | - | 96 868 | 49.0 |
| Corporate bonds | - | 19 236 | - | - | 19 236 | 9.7 |
| Banking industry | - | - | 3 957 | - | 3 957 | 2.0 |
| Mortgage backed securities | 6 914 | - | - | 682 | 7 596 | 3.8 |
| Asset backed securities | 66 157 | 1 667 | - | 2 262 | 70 086 | 35.5 |
| **Total** | **169 939** | **20 903** | **3 957** | **2 944** | **197 743** | **100.0** |
| **Composition weight** | **85.9** | **10.6** | **2.0** | **1.5** | **100.0** | **-** |

[a] The above table applies the most conservative credit rating among Moody's, Standard & Poor's and Fitch ratings.

26. The maturity structure of the cash collateral reinvested against securities lent is shown in table 8.

Table 8
**Maturity structure of the cash collateral reinvested against securities lent, as at 31 March 2009 and 31 March 2010[a]**
(Thousands of United States dollars equivalent)

| | *31 March 2009* | | *31 March 2010* | |
|---|---|---|---|---|
| *Period due* | *Amount* | *Percentage* | *Amount* | *Percentage* |
| Due in one year or less | 373 283 | 78.5 | 163 406 | 82.7 |
| Due after one year through two years | 71 096 | 14.9 | 22 551 | 11.4 |
| Due after two years through three years | 21 018 | 4.4 | 9 947 | 5.0 |
| Due after three years through four years | 8 863 | 1.9 | 1 839 | 0.9 |
| Due after four years through to five years | 1 319 | 0.3 | - | - |
| **Total** | **475 579** | **100.0** | **197 743** | **100.0** |

[a] The maturity structure represents the financial maturities of the reinvested cash collateral, not the legal maturities.

27. As evident from tables 7 and 8, the reinvested cash collateral is fairly liquid with 49 per cent in cash, maintains high quality with over 85 per cent in triple A, and over 82 per cent will be redeemed through maturity within one year. This implies that the cash collateral reinvestment will not make any meaningful impact on IFAD's liquidity level, which is already very high relative to the minimum requirement as reported in the following section IX.

# IX. Liquidity level in IFAD's investment portfolio

28. As at 31 March 2010, highly liquid assets in IFAD's investment portfolio amounted to US$1,234,800,000 equivalent (table 9).

Table 9
**Liquidity level in IFAD's investment portfolio, as at 31 March 2010**
(Thousands of United States dollars equivalent)

| | *Actuals* | *Percentage* |
|---|---|---|
| **Highly liquid assets** | **1 234.8** | **49.3** |
| Short-term instruments | 186.6 | 7.5 |
| Government securities | 1 048.2 | 41.8 |
| **Fairly liquid assets** | **869.7** | **34.7** |
| Non-government securities | 869.7 | 34.7 |
| **Partially liquid assets** | **401.2** | **16.0** |
| Held-to-maturity | 401.2 | 16.0 |
| **Total portfolio** | **2 505.7** | **100.0** |

# X. Risk measurement

29. With the exception of operational cash and held-to-maturity investments, the investment portfolio performance is subject to market movements. Historically, different asset classes have shown different levels of volatility, often referred to as "risk". Volatility is measured in terms of standard deviation of returns from their mean. At 31 March 2010, the standard deviation of IFAD's investment portfolio was 1.42 per cent, compared with 1.54 per cent for the investment policy.[2]

30. Value-at-Risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount that the portfolio could lose in value over a three-month forward time horizon, with a 95 per cent confidence level.[3] Table 10 shows the VaR of IFAD's investment portfolio and that of the investment policy as at 31 March 2010 and for previous quarterly periods.

Table 10
**Value-at-risk (VaR)**
(Forecast horizon of three months, confidence level at 95 per cent)

| | *Investment portfolio* | | *Investment policy* | |
|---|---|---|---|---|
| | *VaR (Percentage)* | *Amount (Thousands of United States dollars)* | *VaR (Percentage)* | *Amount (Thousands of United States dollars)* |
| 31 March 2010 | 1.18 | 29 611 | 1.28 | 32 162 |
| 31 December 2009 | 1.23 | 32 080 | 1.31 | 33 987 |
| 30 September 2009 | 1.27 | 33 245 | 1.31 | 34 272 |
| 30 June 2009 | 1.44 | 36 232 | 1.58 | 39 564 |
| 31 March 2009 | 1.65 | 40 180 | 1.57 | 38 350 |

31. At 31 March 2010, the investment portfolio's VaR was 1.18 per cent, a slight decrease from the end of the previous quarter, and in line with the investment policy VaR of 1.28 per cent. It should be noted that the investment policy VaR is based on the policy allocation (see table 1).

[2] The security lending cash collateral programme is not factored into this volatility measurement.
[3] The security lending cash collateral programme is not factored into this VaR measurement.